

# Policy Decisions Are Critical Determinant of China's Corn Trade

by Frederick W. Crook and Peter A. Riley<sup>1</sup>

**Abstract:** Despite a record crop in 1996, many uncertainties continue to surround the outlook for China's corn exports. China resumed exports of corn in late 1996 and is forecast to be a net exporter in 1996/97. A series of policy reforms opened the agricultural sector to more market forces during the 1980's and early 1990's, but recent changes have made policy concerns more important in assessing trade prospects.

**Keywords:** China, corn, production, exports, policy, price.

## **Record 1996 Corn Crop Suggests Large Exportable Supplies**

Corn demand has grown rapidly in recent years in China as strong income growth has brought increasing consumption of meat and poultry products. China switched from a large net exporter of corn to a net importer during 1994/95 in the face of sharply higher demand. Corn imports were large at over 4 million tons in 1994/95 and 1.5 million tons in 1995/96. This year, China resumed exports of corn while its imports have virtually dried up. China is forecast to be a significant exporter again during 1996/97, with corn imports expected to fall to less than 100,000 tons in 1996/97.

China's corn production in 1996 is estimated at a record 117 million tons, up 5 million from the year before. Corn prices have fallen sharply over the last few months, reflecting the large increase in supply. This also indicates that market forces are at work in the grain economy. However, the central government still exerts the most critical influence on trade. Even with more competitive prices and the strong desire of local authorities to export corn, China has taken a very cautious approach. Exports have proceeded slowly early in 1997 and traders have reported that export licenses have periodically been held up.

Although corn is now overwhelmingly used as a feed grain in China, rather than as a staple food, food security concerns appear to be central to recent agricultural policies affecting corn as well as the major staple grains, wheat and rice.

## **Background: Reforms in Government Grain Policies**

From the mid-1950s to the early 1980s, China's government maintained a tight grip on agricultural production, consumption, domestic marketing and international trade. From 1953 to 1993 urban families were issued coupon books that entitled them to purchase fixed quantities of grain and edible oils at

low fixed prices from government-operated grain stores. Then, in the early 1980s, the government disbanded the commune system, allowed the old pre-1950 marketing system to revive, and set up the household land contract system in which farm households were permitted to sign long term land contracts to cultivate specific plots. As long as farm households delivered specified quotas to local government-owned Grain Bureaus—thus paying their taxes and meeting government grain procurement requirements—the households were free to produce whatever they wanted and were permitted to sell their goods through local open markets.

The central government raised the purchase price of grains to encourage farmers to produce more, but the Grain Bureau retail shops in the urban areas continued to sell rice, flour and corn at low prices that had largely remained constant since the early 1960s. By the late 1980s, China's government found that over 20 percent of total national government revenues was used to finance the gap between the purchase and retail price of grain.

Starting in 1992, the central government introduced market reforms to reduce the burden of the grain subsidies and to improve the economic efficiency of grain markets. By the end of 1993, these market reforms accelerated, as 28 out of 31 provinces began to phase out the grain ration system that allowed urban consumers to purchase grain at low fixed prices. Thus, to many observers it looked like China would steadily pursue an economic course based on free markets and comparative advantage.

## **Government Begins To Reassert Controls in 1994**

Three factors appear to have pushed China's leaders from 1994 to 1996 to reassert government control over grain markets, veer away from the principle of comparative advantage, and restrict market operations. First, inflationary pressures in late 1993-early 1994 and a sharp rise in grain prices in 1994 undermined the government's resolve to carry out market reforms. While there may have been local grain imbalances, on a national basis there does not appear to have been a huge gap between demand and supply. A major factor underlying the general rise in prices was the large increase in

<sup>1</sup> Agricultural economists, Commercial Agriculture Division, Economic Research Service.

the money supply, as the Ministry of Finance was required to issue more money to bail out inefficient state-owned enterprises and to increase wages and bonuses to largely urban workers.

In 1994 and 1995, the government implemented anti-inflationary measures, including price controls. Price stability has always been important to China's central leaders, many of whom witnessed the devastation of hyperinflation at the end of World War II. When the objective of price stability came into conflict with raising farm incomes, China's leaders chose their traditional urban bias of pursuing price stability.

Second, while rural reforms brought relatively rapid increases in grain production in the 1980s, the rate of increase slowed in the 1990s and leaders became concerned about the decrease in the area sown to grains.

Third, in 1994 and 1995, analysts in and outside of China questioned the country's capacity to produce enough grain to meet growing consumption requirements. It is possible that these reports had a sobering effect on the central leaders, pushing them to limit market reforms and initiate the "governors' grain bag responsibility system," a policy designed to promote adequate supplies of domestic grain at provincial levels whenever possible.

### **Governors' Grain Bag Responsibility System Aims At Self-Sufficiency**

In early 1995, the central government initiated a new grain policy in which provincial governors were given responsibility of maintaining the "grain bag." The policy applies to all grain crops—especially wheat, corn, and rice. Under this policy, governors are responsible for: stabilizing area sown to grains; guaranteeing investment in inputs like chemical fertilizer to stimulate grain production; guaranteeing that certain quantities of grain are put into stocks; insuring that transfers of grain in and out of a province are completed; stabilizing urban residents' concerns by supplying grains and edible oils; stabilizing grain and edible oil prices; controlling 70 to 80 percent of commercial grain sales; developing means to control grain markets; raising commercial sales as a share of grain sales; controlling grain imports and exports; and raising the level of grain self-sufficiency.

The "governors' grain bag responsibility system" has operated for less than 2 years, hence little information has been published with which to evaluate its success. However, general observations can be made on the policy's effect on China's grain economy.

First, the implementation of this policy indicates the government's emphasis on self-sufficiency, intervention, and control of the grain economy, and reassertion of its old objectives to support its urban constituents. And in a like manner, it indicates a turning away from emphasis on comparative advantage in production decisions, economic efficiency, participation in world grain markets, open domestic markets, and a return to the old policy of relative neglect of the agricultural economy.

Second, by using government administrative measures, local authorities were able to halt the downward trend of area sown to grains. Plantings for all grains in 1995 increased 516,000 hectares from 1994. Third, this policy encouraged local leaders to pay increased attention to grain production in 1995 and 1996, led to greater government investment in the grain economy, and saw total grain production rise from 445 million metric tons in 1994 to 467 million in 1995 and to a projected record 480 million this year.

Fourth, again by using administrative measures, government authorities were able to halt increases in grain prices and stabilize grain markets. Fifth, in 1995 and 1996 China's participation in international grain trade decreased. In marketing year 1994/95, China imported 18.58 million tons of grain and exported 1.66 million. But in 1995/96, China imported 15.84 million tons and exported 860,000 tons. In 1996/97 China is projected to import 6.4 million tons and export 2 million tons.

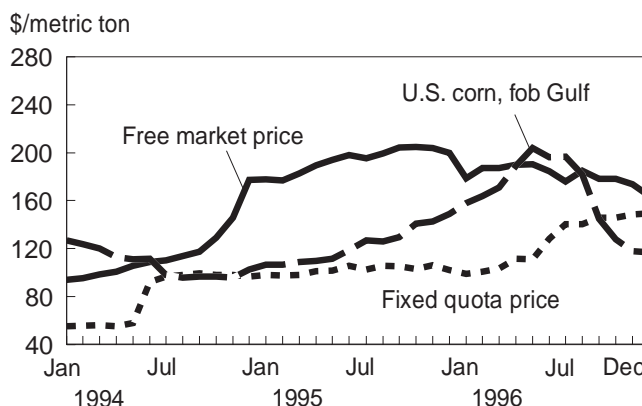
### **Grain Bag Policy Affected China's International Corn Trade**

When world corn prices rose in fall and winter 1996, a number of provinces in China had corn stocks to sell into the international market. These provinces were prevented from doing so by the central government which placed an embargo on corn exports. Presumably this was done to comply with the "grain bag" policy, and northeast provinces were encouraged to ship their corn to feed-deficit provinces in south China.

In spring 1996 government and party leaders pushed farmers to increase corn output for the year. It is clear that farmers responded to administrative measures and prospects of high corn prices in fall and winter 1996. With the help of good weather, farmers reaped a record crop, estimated by USDA at 117 million tons.

With a record crop on hand, and abundant stocks, domestic corn prices fell. (While production estimates are considered to be fairly reliable, China normally does not release data on

Figure B-1  
**China's Monthly Corn Prices & U.S. Gulf Price, Jan. 1994 - Dec. 1996**



Source: Information Center, Ministry of Agriculture, China and USDA.

stocks and information remains sketchy.) In some places the corn market price fell below the government's fixed quota price (see figure). Vice Premier, Zhu Rongji, in January 1997 made a rare comment on China's grain stock situation noting that at yearend China's state grain reserves totaled a record 148.5 million tons, up 34.4 million tons from yearend 1995 (1). In 1991 state grain reserves were reported to be around 120 million tons (2). These sources disclosed total grain stock numbers but gave no breakdown between wheat, rice, and corn, the primary grains held in state stocks. These numbers also exclude on-farm grain stocks. The increase in state-owned corn stocks probably was a factor in the downturn in corn imports and the lifting of the corn export embargo in winter 1997.

### ***Corn Outlook Is Unsettled for 1997***

In winter 1997, leaders in Beijing are concerned that local government-owned Grain Bureaus may lack the cash to purchase all the corn that farmers are willing to sell. They fear

that if the Grain Bureaus stop purchasing corn, farmers will turn deaf ears to government pleas to increase, or maintain corn area for 1997 and will switch to more profitable activities. It is not likely that area sown to corn in 1997 will be higher than in 1996.

It is unknown what administrative directives or policy decisions can do to maintain plantings if price signals point to better profitability for other crops. Even if corn production were to stay relatively high in 1997, evaluation of trade prospects will be difficult because the actual size of corn stocks is not known.

### **References**

1. Reuter, Beijing, January 9, 1997.
2. Li Yan, "Importing Grains To Be Continued," China Daily, Business Weekly, March 19-25, 1995, p. 1.